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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
1998 Biennial Regulatory Review	)	CC Docket No. 98-81
Review of Accounting and Cost	)	
Allocation Requirements	)	
	)	
United States Telephone Association	)	ASD File No. 98-64
Petition for Rulemaking	)	
	)	

COMMENTS OF BELLSOUTH

BELLSOUTH CORPORATION AND
BELLSOUTH TELECOMMUNICATIONS, INC.

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SUMMARY

Section 11 of the Telecommunications Act of 1996 ("1996 Act") contains an unambiguous mandate to the Commission to review and eliminate needless regulation. No area of regulation is more ripe for streamlining than the Commission's accounting and cost allocation rules. The accounting and cost allocation rules were instituted in an era when a carrier's cost also determined its prices. That, however, is no longer the case for large LECs. Price cap regulation has replaced cost based regulation, thereby breaking the link between a company's cost and its prices. Accordingly, many of the rules and regulations that were established to protect consumers under cost based regulation are simply no longer needed.

The Commission should take the opportunity of this Section 11 review to get rid of the many accounting and cost allocation rules that are unnecessary in the light of price cap regulation. The Commission had thoughtful input from the industry prior to issuing the Notice. The Commission, however, proposes to do very little to rid the industry of needless vestiges of cost based regulation, and instead proposes only to reduce some regulation for mid-sized LECs, many of which remain under cost based regulation. This is both ironic and illogical. There is simply no need for extensive accounting and cost allocation regulation of the price cap LECs.

BellSouth does not oppose the changes proposed in the Notice. Indeed, BellSouth contends that any reduction in regulation is good for the industry because it moves the entire industry closer to where it should be – full competition without government interference. The proposals in the Notice, however, should be extended to all LECs. Retaining costly and time consuming regulation of only one class of carrier distorts the competitive marketplace. Section 11 requires the Commission to eliminate marketplace distortions to the fullest extent

possible consistent with the public interest. The Commission should not stop with the changes proposed in the Notice, but should go further and eliminate other rules that are no longer in the public interest. BellSouth proposes many such changes in its Comments. Arthur Andersen has also filed with the Commission an extensive "white paper" analyzing Part 32 of the Rules and proposing changes that would streamline those Rules. BellSouth endorses the analysis and proposal of Arthur Andersen. BellSouth also endorses the changes proposed in the Comments of the United States Telephone Association.

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BellSouth Corporation and BellSouth Telecommunications Inc., ("BellSouth") hereby comment on the issues raised in the Notice of Proposed Rulemaking ("Notice"), FCC 98-108, released June 17, 1998, in the captioned proceeding. For ease of reference, BellSouth has followed the order of presentation of the issues set forth in the Notice.

I. INTRODUCTION

This proceeding was initiated to comply with the requirement in Section 11 of the Telecommunications Act of 1996 (the 1996 Act):

> **Section 11. Regulatory Reform.**
> (a) BIENNIAL REVIEW OF REGULATIONS.--In every even-numbered year (beginning with 1998), the Commission--
> (1) shall review all regulations issued under this chapter in effect at the time of the review that apply to the operations or activities of any provider of telecommunications service; and
> (2) shall determine whether such regulation is no longer necessary in the public interest as the result of meaningful economic competition between providers of such service.
> (b) EFFECT OF DETERMINATION.--The Commission shall repeal or modify any regulation it determines to be no longer necessary in the public interest.[1]

[1] 47 U.S.C. § 161 (emphasis added).

Under Section 11, the Commission is under a statutory mandate to review all of its regulations to see if they are still required in the public interest, not simply a chosen few. The Commission's decision in this proceeding should also be informed by the clear deregulatory intent of the 1996 Act. Specifically, Section 10 requires that the Commission forbear from applying any regulation or provision of the statute that are not necessary to ensure that "the charges, practices, classifications, or regulations" of a carrier "are just and reasonable."[2] Sections 10 and 11 are complementary provisions enacted by Congress to ensure that regulation does not impede the operation of market forces as competition emerges in the telecommunications industry.

In light of the clear statutory directive to review all regulations and to remove or modify those that are no longer necessary, BellSouth is extremely disappointed with the failure of the Notice to request comment on the many accounting and cost allocation regulations that no longer serve the public interest. The Notice proposes no meaningful reduction in regulation of large local exchange carriers ("LECs"), the entities most heavily regulated by the Commission. One would assume that with the plethora of accounting and cost allocation rules and regulations that apply to the large LECs, the Commission could identify some regulations that are no longer needed to protect the public interest.[3]

[2] 47 U.S.C. § 160. Section 10 forbearance also requires a finding by the Commission that the statute or regulation in question "is not necessary for the protection of consumers" and that forbearance "is consistent with the public interest." In making its public interest determination, Section 10(b) requires the Commission to consider "whether forbearance from enforcing the provision or regulation will promote competitive market conditions, including the extent to which such forbearance will enhance competition among providers of telecommunications services."

[3] BellSouth acknowledges the limited account consolidation proposed in Section IV of the Notice. Those changes do little to reduce the heavy burden imposed by the Commission's accounting rules and requirements.

This failure to identify and propose the elimination of unnecessary regulation is even more disappointing considering that, during the formulation of the Notice, the Commission Staff requested and received thoughtful input by the LEC industry on areas of unneeded, outdated, and useless regulation. The Accounting Safeguards Division ("ASD") informally asked industry to suggest rule changes during the development of the Notice. BellSouth provided the ASD with ten suggested changes. Not one was included in the Notice for comment.[4] The other large LECs, Ameritech, Bell Atlantic, and SBC also provided suggestions that received only nominal consideration. Moreover, the United States Telephone Association ("USTA") responded to the ASD's request with written comments, held discussions with the ASD's staff, and even revised their suggestions to provide additional information requested by the ASD. However, the Notice relegates USTA's suggestions to a few items in Part IV. BellSouth finds it incredible that with the amount of input provided, the ASD did not find that the suggested changes even warranted comment.

The Notice overlooks the major concerns expressed by the large LECs, and instead, suggested limiting meaningful regulatory relief of accounting and cost allocation rules for mid-sized LECs only. There is simply no basis in the statute for such a "carve out." Section 11 requires the Commission to review all regulations that apply to the operations of any provider of telecommunications services. Thus, the Commission must address in this proceeding the continuing necessity for each regulation that it proposes to retain for any provider of telecommunications services, including the large LECs. The Notice does not begin to meet that statutory obligation.

[4] Pursuant to ¶ 19 of the Notice, BellSouth has included its recommendations to the ASD in Section IV, B, infra.

The large LECs' frustration over the Commission's failure to address the need to eliminate archaic accounting and cost allocation rules cannot be overstated. BellSouth finds it both incongruous and ironic that rules designed for use with cost based rate of return regulation will now be applied only to the very carriers that the Commission has removed from that form of regulation. The large LECs have been subject to mandatory price regulation since 1990. It is impossible not to recognize that accounting and cost allocation rules designed to complement the cost of service paradigm may have become a regulatory dinosaur in a price regulation environment. The price regulation paradigm breaks the link between accounting costs and rates, thereby eliminating the need for the detailed accounting and cost allocation rules currently imposed on the large LECs. Ironically, many of the mid-sized LECs remain under cost of service regulation. Thus, the Notice proposes to reduce regulation of carriers for which the regulation was designed, but keep the regulation on those carriers to which it no longer applies. It is hard to imagine a more arbitrary and capricious outcome or a more egregious breach of statutory duty.

The Notice contains no meaningful analysis of the relationship between price regulation and the accounting and cost allocation rules. That analysis should frame the Commission's entire review of the continuing need for accounting and cost allocation rules for the Bell Operating Companies ("BOCs") and other price cap LECs. Any such analysis would clearly show that many of the accounting and cost allocation rules are simply unnecessary vestiges of cost based, rate of return regulation.[5] These rules are extremely costly to implement and serve no necessary purpose. The fact that to date the Commission has seen fit to retain some vestiges

[5] The lobbying expense audit cited in footnote 19 of the Notice is illustrative of the reduced need for detailed accounting under price regulation. There the Commission states that its auditors identified $118 million in lobbying costs that the BOCs allegedly improperly included in their revenue requirements between 1989 and 1991. Accepting these unsubstantiated allegations at

of cost of service regulation in the LEC price cap plan is an insufficient basis to retain the full panoply of accounting and cost allocation rules that exist today. The Commission's apparent intent to retain such unnecessary regulation is contrary to Congress' express directive, and contrary to the public interest.

On July 15, 1998, Arthur Andersen filed with the Commission an extensive white paper analyzing the existing accounting, cost allocation and affiliate transaction rules. The white paper demonstrates that the existing rules no longer reflect the existing regulatory and competitive paradigm and impose unnecessary and costly constraints on the carriers subject to their requirements. Arthur Andersen recommends a transition plan that will ultimately lead to the elimination of Part 32 in favor of GAAP accounting. BellSouth strongly endorses the proposals in the Arthur Andersen paper.

II. STREAMLINING ACCOUNTING REQUIREMENTS FOR MID-SIZED INCUMBENT LECs

A. Monitoring of Competition and Compliance with Telecommunications Act of 1996 ("1996 Act") as Basis for Continuing Class A Accounting for Large LECs Has No Merit

Paragraph 6 of the Notice states "the more detailed Class A accounting is required to monitor the large incumbent LECs as competition begins to develop in local telephony markets. The more detailed accounting requirements are also necessary for the Commission to uphold our statutory obligations under Sections 254(k), 260, 271, 272, 273, 274, 275, and 276 of the Act."[6]

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face value for discussion purposes only, under price regulation there have been no "revenue requirements" that dictate rate levels for eight years. Thus, even if costs now were improperly classified under price regulation, they would not affect a carrier's rates, and would not influence whether such rates are "just and reasonable." Hence, the public interest reason for maintaining strict regulatory oversight of cost classifications through Class A accounting is largely supplanted by the price regulation regime itself.

[6] Notice at ¶ 6 (footnotes omitted).

As discussed below, neither of these assertions are valid reasons to require the large LECs to continue Class A accounting.[7]

1. Class A Accounting Is Not Needed to Monitor Large LECs as Competition Develops in Local Telephony Markets

BellSouth strongly disputes the Commission's unsupported assertion that it needs more detailed regulation to monitor the large LECs as local competition develops.[8] This assertion is directly contrary to both the statute,[9] prior Commission decisions, and the publicly stated views of individual commissioners

Section 11 expressly directs the Commission to repeal or modify unnecessary regulation. The statute itself refers to the existence of competition as evidence that the public interest no longer requires detailed regulation. Section 10(b) directs the Commission to forbear when doing so will "promote competitive market conditions." Forcing certain carriers to bear unnecessary administrative costs that do not apply to their competitors damages, rather than promotes,

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[7] The Notice states: "Class A accounting rules allows us to identify potential cost misallocations beyond those revealed by the Class B system of accounts." Notice at ¶ 6. The lobbying expense example in footnote 19 simply does not support this assertion. According to the footnote, lobbying expense is recorded in Account 7370, Special Charges. The footnote postulates that aggregation of the expenses recorded in Account 7370 and seven other accounts into Account 7300, Non-operating Income and Expense, would not readily permit the Commission to identify discrepancies and would significantly complicate monitoring and oversight efforts. This assertion is simply incorrect. Account 7370 itself includes a variety of costs, such as social club dues, charitable contributions etc. in addition to lobbying expense. Therefore, merely reviewing the account balance would not enable an analyst or auditor to tell what lobbying costs, if any, are included in the account. In the lobbying expense audit, the Commission staff distributed questionnaires that provided a definition of lobbying, and required the carriers to quantify lobbying expenses incurred and the account charged. Recording these costs at the Class B account level would in no way impede the staff's ability to obtain similar information in the future.

[8] Notice, ¶¶ 6, 12.

[9] Telecom Act. 110 Stat. 56 ("An Act to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies.) See also H.R. Conf. Rep. No. 104-458 at 1, 113 (noting that the purpose of the Telecom Act is to "provide a pro-competitive, de-regulatory national policy framework.")

competitive market conditions. Thus, the basic premise underlying the Notice is contrary to statutory direction.

In addition to being inconsistent with the 1996 Act, the theory that more competition requires more regulation is inconsistent with prior Commission decisions. The Commission has long recognized and often stated that regulation is a substitute for competition, providing a check on anticompetitive behavior in the absence of market discipline. As a field becomes more competitive, the rational response is to reduce, not increase, regulation.[10] Indeed, the Commission itself has held that under the 1996 Act, it is less likely that LECs will act anticompetitively.[11]

The notion that increased competition requires more regulation is also contrary to the policy direction espoused by individual commissioners. During his confirmation hearings, Chairman Kennard stated that the industry should be moving away from "government micromanagement" to "common sense pro-consumer deregulation."[12] Commissioner Furchtgott-Roth notes in his separate statement attached to the Notice, " ... regulation is merely designed, to the extent possible, to replicate a competitive marketplace, but any form of regulation is an imperfect surrogate for full-fledged competition."

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[10] See, e.g., Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefore, CC Docket No. 79-252, Fifth Report and Order, 98 F.C.C.2d 1191 (1984). See also, Policy and Rules Concerning the Interstate, Interexchange Marketplace, CC Docket No. 96-61, Second Report and Order, 11 FCC Rcd. 20,730 (1996), appeal pending sub nom., MCI Telecommunications Corp. v. FCC, No. 96-1459 (D.C. Cir. Filed February 13, 1997); Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, 11 FCC Rcd 3271 (1996), recon., 12 FCC Rcd 20,787 (1997).

[11] See, Access Charge Reform, 12 FCC Rcd 15,982, 16,102, recon., 12 FCC Rcd 10,119, further recon., 12 FCC Rcd 16,606 (1997), pets. For review pending.

[12] Statement of William E. Kennard, Confirmation Hearing before the Commerce, Science and Transportation Committee (October 1, 1997).

Thus, the statute, prior Commission decisions, and the statements of individual commissioners all stands for the proposition that as competition increases, regulation should be decreased. The Notice ignores this basic truism and, in fact, assumes the opposite. This illogical rationale should be recanted. It forms no reasonable basis for retaining Class A accounting for the large LECs.

2. Class A Accounting Is Not Needed to Monitor 1996 Act Compliance

a. Sections 254(k), 260, 271, 275, and 276

As BellSouth has demonstrated, the price cap rules essentially eliminate any incentive or ability of price cap carriers to use "services that are not competitive to subsidize services that are subject to competition."[13] With the fundamental changes being wrought in the industry, no telecommunications carrier can count on "services that are not competitive" to subsidize competitive services. Advances in technology and the removal of legal barriers to entry, culminating in the passage of the 1996 Act, make any such safe harbors from competition elusive and ephemeral. Contrary to the naked assertion in the Notice that Class A accounting is needed for the Commission to uphold its statutory obligations, such detailed regulation is not necessary to accomplish the goal of Section 254(k) of the 1996 Act.[14]

Price regulation likewise eliminates any incentive for large LECs to subsidize telemessaging services, § 260; interLATA services, § 271; alarm monitoring service, § 275; or payphone services, § 276. Furthermore, competitive regulated services, such as incidental interLATA services in § 271, are tariffed and receive regulatory scrutiny through the tariff

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[13] Notice at ¶ 6.

[14] 47 U.S.C. § 254(k).

process. Accordingly, the Commission should not require the large LECs to continue under Class A accounting based on this faulty reasoning.

b. Sections 272, 273, and 274

The Commission's assertion that the detailed accounting requirements of Class A should remain in effect for BOCs so that the Commission can fulfill "its statutory obligations" related to separate affiliates in Sections 272, 273, and 274 is unsupported and erroneous. These sections govern the separate affiliates of a BOC, not the BOC itself. Moreover, the separate affiliates have their own set of accounting books that are not subject to Part 32 accounting.[15] As BellSouth has set forth herein, because the large LECs are under price regulation there is no incentive on the part of these LECs to subsidize their unregulated affiliates, and no incentive for the unregulated affiliates to subsidize the large LEC.

B. Size of the LEC is an Improper Basis for Determining Which LECs Are Required to Continue Class A Accounting

BellSouth concurs in the Notice's proposal to relieve mid-size carriers of the Class A accounting requirements and commends the Commission for proposing this long over-due change. BellSouth, however, disagrees with the specious rationale the Commission used to justify the continued imposition of Class A requirements for large LECs.

The Notice proposes to use size, based on revenue, as the criterion for deciding which carriers will be classified as mid-sized LECs, and which will be classified as large LECs. In determining who falls within the definition of a mid-sized LEC, the Commission arbitrarily selected a $7 billion-dollar revenue threshold. All carriers with revenue less than $7 billion

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[15] Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996, 11 FCC Rcd 17539, 17618 (1996) ("Accounting Safeguards Order") at ¶ 170.

dollars are categorized as mid-sized and receive Class B treatment, while all carriers above $7 billion dollars in revenue receive Class A treatment.[16] In an attempt to justify this rationale and continue to impose Class A accounting requirements on large LECs, who are no longer under cost based rate of return regulation, while permitting "mid-sized" LECs, who remain under cost based rate of return regulation, to use Class B level accounting, the Notice states:

> We have reached this conclusion because we have generally found that mid-sized carriers typically conduct a lower volume of transactions involving competitive products and services than the large incumbent LECs, thus providing easier monitoring and oversight because there are fewer opportunities for these mid-sized carriers to subsidize competitive services with the revenues earned from the provision of noncompetitive services.[17]

These Comments have demonstrated, however, this selection criterion completely ignores essential fact with which the Commission should be concerned in determining regulation that is no longer in the public interest, namely that for price cap carriers the link between accounting costs and rates has been severed. Price regulation protects ratepayers against cross-subsidization of non-regulated services in a way that can never be achieved through detailed accounting and cost allocation rules. This method of setting rates does not allow carriers to pass through increases in booked cost to ratepayers. Therefore, the proposal to use size as the measure of risk of ratepayer cross-subsidization of competitive services and the proposal to continue imposing Class A accounting requirements on the very companies whose ratepayers are protected from such risks by price regulation, is patently illogical.

In proposing to use size to segregate which carriers will receive Class B accounting, the Notice places considerable emphasis on the volume of transactions a carrier completes. The

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[16] It comes as no surprise that the only carriers that must now continue Class A accounts are the BOCs and GTE. The only mystery is why the Commission put forth the thinly veiled pretense of a dollar threshold in selecting these carriers.

[17] Notice at ¶ 5.

Commission draws the conclusion that the larger the number of transactions involving competitive services the greater the risk that an entity will cross-subsidize its unregulated services with its regulated services. BellSouth believes the volume of transactions involving competitive services is not an appropriate benchmark for assessing the risk that ratepayers will attempt to cross-subsidize competitive services. Instead a more appropriate benchmark is the relative amount of resources devoted to providing competitive services. Factual information for large telecommunications carriers is contained in the ARMIS reports (i.e., 43-03) filed each year with the Commission. Line 720 of these reports show each carrier's total operating expenses and the portion of these expenses assigned to competitive services (i.e., non-regulated products and services). Likewise, Line 2001 shows each carrier's total assets and the portion of those assets used to provide competitive services (i.e., non-regulated products and services). The following table shows the amount and percentage of BellSouth resources devoted to the provision of non-regulated products and services in 1997. This information is taken directly from lines 720 and 2001 of the ARMIS 43-03.

(BILLIONS)

	REG	NON-REG	TOTAL	NON-REG %
LINE 720	$ 9.5	$ .7	$ 10.2	6.86%
LINE 2001	46.5	.7	47.2	1.48%

The proportion of BellSouth resources devoted to competitive non-regulated products and services is tiny. The risk of ratepayer cross-subsidization is de minimis and does not support the Notice's proposal to continue Class A Accounting requirements for telecommunications carriers with revenues of $7 billion.

BellSouth believes neither the volume of transactions involving competitive products and services nor the amount of resources used to provide competitive products and services justify continuing to impose Class A Accounting requirements on these carriers whose rates are set under price regulation. There is no direct link between BellSouth's costs and the rates it charges for noncompetitive services. Therefore, the risk of ratepayer cross-subsidization of competitive products and services under the current price regulation regime is virtually non-existent. The Commission has a clear mandate under Section 11 of the 1996 Act to "repeal or modify any regulation it determines to be no longer necessary in the public interest."[18] To comply with that mandate, the Commission should eliminate the Class A accounting requirements for BellSouth and other carriers under price regulation. BellSouth urges the Commission to embrace, not ignore, the statutory mandate of Section 11 of the 1996 Act.

III. COST ALLOCATION MANUAL ("CAM") REQUIREMENTS FOR MID-SIZED INCUMBENT LECS

A. The Notice Does Not Adequately Address CAM and Affiliate Transaction Rules

1. CAM Rules

Many of the mid-sized LECs remain under rate of return regulation instead of price regulation. Therefore, cost allocation requirements are arguably relevant to those carriers. BellSouth, however, does not oppose the proposed changes to the mid-sized LECs accounting and cost allocation requirements set forth in the Notice. Indeed, such changes should be applied to large LECs as well. Furthermore, BellSouth believes that the Commission did not go far enough in its proposals to modify the cost allocation rules. Many other opportunities exist to repeal or modify regulations that are no longer in the public interest. Pursuant to paragraph 19 of the Notice, BellSouth requests the Commission to make the following changes to the cost allocation rules for all LECs.

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[18] 47 U.S.C. § 161(b).

a. Eliminate the requirement for network usage forecasts.

The process of allocating Central Office and Outside Plant accounts could be simplified by no longer requiring 3-year usage forecasts. Requiring such detailed and complicated processes is costly with no added public benefit.[19] Other regulatory processes such as Parts 36[20] and 69[21] do not require such a detailed and complex 3-year forecast for allocating network investment. This allocation, if it is retained at all should be based on actual usage.

b. Eliminate the requirement to treat competitive regulated service as non-regulated for accounting purposes.

Competitive regulated services, such as incidental interLATA services, are tariffed and receive regulatory scrutiny through the tariff process. The ratepayer is already protected, and the requirement for non-regulated accounting treatment amounts to an unnecessary and time-consuming additional burden on the LECs. It is extremely difficult to track, identify and apply usage based allocators for these services. Moreover, Part 64 is not necessary to insure there is no cross subsidization between competitive and noncompetitive services for the purposes of Universal Service.[22] The universal service cost models use a forward looking cost accounting process. Both competitive and noncompetitive services support the School, Library and Rural Health Care fund. The support provided to this Fund has nothing to do with Part 64 cost allocation. Furthermore, the process for determining whether a customer qualifies for low-

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[19] Part of the Commission's justification for retaining Class A accounting is the assertion in Paragraph 6 of the Notice that large LECs maintain detailed records for management purposes, and hence the Commission's requirements pose no incremental burden. That is clearly not true with regard to requirements, like this one, that are useless for management purposes.

[20] 47 C.F.R. §§ 36.1, et seq.

[21] 47 C.F.R. §§ 69.1, et seq.

[22] See, 47 U.S.C. § 254(k).

income support does not use Part 64. See Attachment 1 for modifications of rules to implement this recommendation.

c. Revise the calculation of non-regulated income taxes.

Currently, non-regulated income taxes are calculated using the Specifically Defined Book Income ("SDBI") factor (non-regulated taxable income/combined taxable income) times combined booked tax. Carriers occasionally have out-of-period taxes. This usually occurs at least once a year when the carriers complete their income tax return for the previous year and book the tax true up. There are also times when carriers book large revenue refunds that are 100% inter-state or intra-state. At either of these instances, the SDBI calculation creates distorted non-regulated taxes.

BellSouth proposes the following: when significant out-of-period taxes can be identified and are booked, that the non-regulated tax calculation be:

current book tax x current SDBI factor = non-regulated tax (1)
out-of-period tax x historical SDBI factor = non-regulated tax (2)

Adding these two calculations, (1) + (2), together gives you total non-regulated tax. The historical SDBI factor would be calculated based on the period to which the out-of-period taxes apply. If there is a large revenue refund to any jurisdiction, the appropriate applicable booked tax should be identified and excluded from the non-regulated tax calculation unless they apply to non-regulated revenue in which case the applicable taxes would be 100% non-regulated.

d. Require only one annual CAM filing – eliminate 15-day notice.

Section 402(b)(2)(B) of the 1996 Act[23] mandated that the Commission permit carriers to file CAMs on an annual basis. By requiring carriers to file changes to the cost apportionment

[23] 47 U.S.C. § 214, note.

table and to time reporting procedures 15 days prior to implementing those changes, the Commission has, in effect, required carriers to file CAM changes more often than annually. This is contrary to the intent of the 1996 Act. Multiple CAM filings often are necessitated by minor changes in non-regulated product offerings or the processes associated with these products. The current requirement causes continuing burdensome activities in making multiple CAM filings each year. BellSouth proposes that the CAM be updated on or before the last working day of the calendar year for all changes that were effective in that calendar year.

e. Eliminate the requirement to quantify CAM changes.

Large LECs are required to file cost allocation manuals and to quantify estimated changes to time reporting procedures, affiliate transactions and cost apportionment tables. It is not the quantification, but the appropriateness of the change itself, that should be the basis upon which a CAM change is accepted or rejected. Additionally, the large LECs are price regulated, which breaks the link between accounting cost and price. Such carriers should no longer be required to expend resources to estimate the quantification of CAM changes.

f. Eliminate the non-regulated product matrix from the CAM.

Part 64 requires that costs be allocated between regulated and non-regulated activities, but does not require the allocation on a product by product basis.[24] The non-regulated product matrix (Section 2) requires account impacts by products, even though the LECs are not required to track these costs by products. It is time-consuming to update and maintain this matrix in the CAM. BellSouth proposes that this matrix be eliminated.

[24] 47 C.F.R. § 64.901.

g. Reduce the level of detail required in the chart of affiliates.

In the Joint Cost Order, the Commission required that each carrier include a chart showing all of its corporate affiliates in its cost allocation manual.[25] This has become a very burdensome requirement as carriers have expanded operations abroad and into numerous non-regulated areas and have entered into many partnerships and joint ventures in varying percentages of ownership. Only a minute fraction of these affiliates engage in transactions with the LECs but all are required to be included in the chart. It is a very time-consuming exercise to maintain such a detailed document. Currently, BellSouth has no business need for such a chart, and therefore does not prepare such a chart for its own internal purposes. In addition, some affiliates are created prior to launching new competitive services, and filing such information in the CAM, when there is no affiliate transaction impact, puts BellSouth at a competitive disadvantage. The requirement to include this level of detail is excessive and is not necessary to achieve the purposes behind the CAM and the affiliate transaction rules. A chart of affiliates showing only those affiliates having transactions with BellSouth Telecommunications, Inc. should be sufficient to achieve the Commission's purposes. At the very least, a listing of affiliates showing reporting relationships could be substituted for a chart format.

2. Affiliate Transactions Rules

In the Joint Cost Order,[26] the FCC stated that "Our goal in establishing standards for transactions between affiliates is to prevent cost shifting to ratepayers by means of improper

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[25] Separation of Costs of Regulated Telephone Service from Costs of Nonregulated Activities; Amendment of Part 31, the Uniform System of Accounts for Class A and Class B Telephone Companies to Provide for Nonregulated Activities and to Provide for Transactions Between Telephone Companies and their Affiliates, 2 FCC Rcd 1298, 1328 qt ¶ 240 (1986) ("Joint Cost Order").

[26] Id., at ¶ 290.

transfer pricing." As discussed above, the concern was that such pricing would result in increased regulated revenue requirements to be recovered from ratepayers. While relevant in the traditional rate of return regulation environment, it is clearly far less relevant under the current price regulation model. Under price regulation the impact of affiliate transactions on regulated products/services pricing is virtually eliminated. The FCC, however, has imposed additional burdensome requirements on the large LECs with respect to affiliate transactions, such as requiring fair market value calculations on services provided between affiliates and requiring that non-regulated services provided to a non-regulated affiliate be subject to the affiliate transaction rules.[27] These are clearly examples of unnecessary accounting regulations that the 1996 Act requires the Commission to minimize. BellSouth proposes that these newly minted requirements be eliminated.

a. Eliminate the requirement for fair market value calculations on services provided between affiliates.

The requirement to value services provided between affiliates at fully distributed cost is more than sufficient to protect ratepayers, especially in light of price regulation. The 1996 Act does not permit multiple layers of protection when one is sufficient. Determining the fully distributed cost of these service transactions is a burdensome process by itself; the additional burden of determining the fair market value of each and every service transaction is not justified by the de minimis, if any, benefit that it might provide. At the very least, BellSouth proposes that the current exemption granted to affiliates that exist solely to provide services to the corporate family should also be granted for any service provided only within the corporate family.

[27] 47 C.F.R. § 32.27.

b. Eliminate the requirement that non-regulated activities performed for non-regulated affiliates be subject to the affiliate transaction rules.

The Part 64 CAM process removes the fully distributed cost of non-regulated activities from regulation. It is entirely unnecessary to overlay the affiliate transaction rules on top of the Part 64 allocation process for these activities. In effect. the Commission is requiring carriers to further break down the non-regulated costs, which have already been removed from regulated operations, into the amounts attributable to affiliates and non-affiliates as well as the amount attributable to each transaction with each affiliate. In addition, due to the increased burden of the new affiliate transaction rules ordered in the Accounting Safeguards Order, the non-regulated services must incur costs to document both estimated fair market value and fully distributed cost of services provided to affiliates when the 50% test is not met. This is a mandated cost burden which competitors are not forced to incur. This anti-competitive requirement is contrary to the goal of the 1996 Act to foster competition. BellSouth submits that the Commission should remove this additional accounting requirement.

B. Proposed Audit Changes

BellSouth supports the decreased audit burden proposed for the mid-size LECs, but believes the arguments for decreasing this burden also apply to the large LECs. The proposal to reduce the audit burden for mid-sized LECs concedes that the Commission can fulfill its statutory obligations using less burdensome regulation. Therefore, under Section 11, the Commission is required to modify its audit requirements for the large LECs as well. Prior to the December 17, 1990 order in the Computer III Remand Proceedings,[28] the Commission required

[28] Computer III Remand Proceedings; Bell Operating Company Safeguards; and Tier I Local Exchange Carrier Safeguards, 6 FCC Rcd 174 (1990) ("Computer III Remand Proceedings").

an annual attest audit as one of the Joint Cost Order compliance safeguards. With the December 17th Order the Commission changed the annual audit to a financial statement audit.

The Kohler's Dictionary for Accountants provides useful definitions for these two different types of audits.

> **Attest** To authenticate formally, as in a report; to express, after careful investigation, an opinion of correctness or fairness as in the auditor's short-form report. "Attest function" refers to extension of the public accountant's role to any situation where others may call upon him or her for an objective statement of fact or opinion that may assist in the making of judgments.
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> **Financial statement audit** The audit of a set of financial statements as of a specific date and for a designated period of time. Statements usually include: statement of financial position, statement of net earnings and stockholder's equity, and statement of changes in financial position. The period covered is usually one year when outside financial audits are involved. Interim statements may also be issued on a quarterly or monthly basis, usually without involving outside auditors in their preparation.

Certainly the external auditor's role in performing any type of audit related to the LEC's compliance with the Commission's accounting rules is more accurately reflected in the "extension of the public accountant's role ... where he or she [is] called upon for an objective statement of fact or opinion that may assist in the making of judgments by others [the Commission]." Thus, an attest audit is fully sufficient, and far less burdensome, than a financial statement audit.

With the change to a financial statement audit in the December 17th Order, the Commission doubled the cost of the annual audit for BellSouth. Although the financial statement audit requires more external auditor hours and, hence, a greater cost to BellSouth, the Commission receives the same basic opinion from the independent auditors, i.e., that BellSouth has complied with the Commission's accounting safeguards.

Because BellSouth is subject to price regulation, there is even less of a need for an expensive compliance audit than for those mid-size LECs who are still under rate of return regulation. However, the Commission proposes to grant these mid-sized LECs relief from the burden of the expensive financial statement audit. Accordingly, continuing to require a full financial statement audit of the large LECs when an attest audit is acceptable for those carriers under rate of return regulation is anti-competitive and contrary to the 1996 Act.

Additionally, the Commission should not only apply the attest audit standards to the annual accounting safeguards audit, but this audit should be performed only on a biennial basis. Paragraph 11 of the Notice concedes that the Commission can fulfill its regulatory oversight obligations through a biennial audit. That being so, Section 11 of the 1996 Act requires the Commission to reduce the regulatory burden for the large LECs as well. Thus, the Commission should reduce the audit frequency, or eliminate completely the audit requirement for all carriers under price regulation, since the apportionment of costs being audited has no impact upon the ratepayer.

IV. ACCOUNTING CHANGES

A. The Commission Should Implement Changes Proposed Prior to the Notice

Prior to the issuance of this Notice the staff requested input on proposals to simplify the Commission's accounting and cost allocations rules. As mentioned above, BellSouth initially provided written proposals in March 1998. At the staff's request, USTA members met and presented written proposals and then provided the staff with marked up sections of the Commission's accounting and cost allocation rules to show the changes in Part 32 required to implement these proposals. Additionally, several of USTA's members, including BellSouth, filed detailed proposed changes to these rules. Moreover, Southwestern Bell filed a Petition for